IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 524

HARRY STEIN, t/a JEAN CHEMICAL CO.

and

NATIONAL UNION INDEMNITY COMPANY,

Petitioner,

vs.

UNITED STATES OF AMERICA

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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THE UNITED STATES OF AMERICA.

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of Harry Stein, trading as Jean Chemical Company and National Union Indemnity Company, a corporation, respectfully represent:

That on January 8, 1940, the District Court of the United States for the Eastern District of Pennsylvania entered judgment against the petitioner, National Union Indemnity Company, particularly on a bond executed by the petitioner in support of a permit issued to Harry Stein, trading as Jean Chemical Company, for the purpose of protecting the government of the United States against loss of taxes due on alcohol denatured under the provisions of the

Act of 1906, and permitted to be withdrawn tax free pursuant to such provision if in the event such tax free alcohol so withdrawn should be diverted to beverage purposes.

The facts are that the principal Stein applied for and received a permit to withdraw alcohol tax free under the provisions of the Act of 1906 (c. 3047, 34 Stat. 217), pursuant to which application a permit was duly issued to Stein and he withdrew under the terms thereof certain quantities of specially denatured alcohol for the purpose of using the same in the manufacture of toilet preparations, the formulae of which had been duly approved by the Division of Technology, Bureau of Internal Revenue, Treasury Department, Washington, D. C.

Thereafter on various dates in June of 1928, Stein withdrew certain quantities of specially denatured alcohol for the purpose of manufacturing the same in various designated toilet preparations, using the entire quantity of specially denatured alcohol so withdrawn in such manufacture. At the time of the manufacture involved, agents of the Prohibition Unit, then so designated, were present to witness such manufacture for the purpose of observing as to whether or not the quantities of alcohol withdrawn by Stein were actually consumed in the manufacture of the commercial toiletry products approved for manufacture by the Bureau of Internal Revenue.

The government contended that the manufacturer, Stein, while consuming and using the quantity of alcohol so withdrawn in the permitted manufacture, deviated from the approved formulae by injecting or introducing into the product an essential oil of an inferior quality, and that thereafter, upon completion of manufacture, sold his product to persons whose purpose it was to sell the same to other persons who had in mind the objective of manipulating the manufactured product in such a way that by the process of simple distillation, foreign ingredients such as essential oils and the basic ingredients of the specially de-

natured alcohol formula, might be readily removed to the end that a potable distillate fit for beverage purposes might be obtained and the resultant effect produce a taxable potable beverage diverted from industrial or commercial purposes to beverage purposes.

The Statement of Claim filed by the government, Record Page 16 claims for its first cause of action that the principal, Stein, pursuant to permit duly issued, executed a bond with the present petitioner, National Union Indemnity Company, as surety, on or about April 18, 1928, which bond was made part of the Record in the District Court and which appears, insofar as the obligatory part thereof is concerned, in the Record on Page 17. The Statement of Claim contended that between the 4th day of June and the 4th day of August, 1928, the principal of said obligation, diverted to beverage purposes 4472 wine gallons of specially denatured alcohol withdrawn tax free, but to which a tax would attach in the event that said alcohol so withdrawn was used for beverage consumption, the Statement alleging further that the principal failed to pay the tax of $2.00 per wine gallon attaching to such alcohol unlawfully diverted, lost or unaccounted for in violation of the terms of his permit and of the obligation of the bond. As for a second cause of action in the said Statement of Claim, the government alleged that between the dates of June 4th, 1928 and August 4th, 1928, the said Harry Stein, principal on the said bond, withdrew 4472 wine gallons of specially denatured alcohol free of tax in accordance with Section 11, Title III, Act of October 28, 1919 (41st Stat. 321), alleging that basic taxes as provided by various provisions of the Internal Revenue Laws would apply to the extent of $1.10 per proof gallon of such specially denatured alcohol withdrawn tax free and diverted to a use either unaccounted for or unauthorized. In Paragraph 19 of the Statement of Claim, the claimant contends that by reason of the said diversion and failure to account for the said 4472 wine gallons specially denatured alcohol withdrawn

by the principal on said bond, said principal wilfully attempted to defeat and evade and did defeat and evade payment of the taxes levied by Statute and more particularly referred to in other portions of the Statement of Claim, Record Pages 16 to 22.

The petitioner contends that the evidence below and particularly that evidence set out in the Appendix of the Appellant's Brief in the record filed with the Circuit Court Pages 31 to 39 does not in any way sustain the finding that the principal Stein in any way diverted actually or indirectly by cooperation with persons whom he knew intended to divert, and therefore the penal obligation of the bond is not involved, since the evidence could not tend to sustain measurable damages based on the tax rate applicable to alcohol used for beverage purposes.

There are certain Sections of the Internal Revenue Laws including Titles 2 and 3 of the National Prohibition Act, which are hereinafter set forth, Act, c. 85, 41 Stat. 305, Sections 4, 5, 9 and 29.

STATEMENT OF QUESTIONS INVOLVED

1. The Court erred in its finding of fact that the evidence tended to sustain tax liability on the part of the principal and hence the National Union Indemnity Company, as surety.

2. The Court erred in its conclusions that the cause was not a tax suit but was instead a suit on a bond.

3. The bond did not become operative until such time as tax liability was established on the part of the principal.

4. The government not having established tax liability upon the part of the principal within the period of limitation could not thereafter proceed against either principal or surety for the collection of taxes, the amount of which had not been liquidated or determined within the period of the Statute.

BRIEF IN SUPPORT OF PETITION

The opinion of the Trial Judge, Kirkpatrick J. and the specific findings of fact are totally unsupported by evidence, copies of which are included in the Record certified to the Circuit Court and appearing in this Record at Pages 43 to 45. Pursuant to the filing of such opinion, motion was filed by the petitioner for amended findings of fact and for a new trial, which was denied because the Court found that the argument of the petitioner centered around the fourth finding of fact as contradicted by the petitioner to the effect that "the product was manufactured in accordance with the formula". The Court in considering the petition so filed referred to the opinion of the District Court filed in the revocation proceedings involving the existence of the permit issued to the principal Stein, which opinion was affirmed by the Circuit Court of Appeals in *Stein vs. Doran*, 46 Fed. 2nd 738, the Court entirely losing sight of the fact that the proceeding before it was utterly different than the proceeding involved seeking revocation of such permit, and therefore, not only a different quantum of evidence was necessary, but an entirely different type of evidence in that in the revocation proceedings the testimony had to do with the trust and confidence of the government as reposed in Stein and his necessity and use of and for the specially denatured alcohol granted to him tax free by virtue of the permit, while in the second case the issue involved was as to whether or not permittee had *actually* diverted the alcohol so withdrawn tax free to a potable beverage and taxable purpose, either deliberately or had cooperated or conspired with third persons with full knowledge of their intentions to the end that the alcohol so accorded him tax free might evade the payment of just taxes attachable to beverage alcohol. In this connection the Court's attention is respectfully called to the provisions

of Sections 4 and 5 of Title 2 of the National Prohibition Act, c. 85, 41 Stat. 305, reading as follows:

"Sec. 4. The articles enumerated in this section shall not, after having been manufactured and prepared for the market, be subject to the provisions of this Act if they correspond with the following descriptions and limitations, namely:

(a) Denatured alcohol or denatured rum produced and used as provided by laws and regulations now or hereafter in force.

(b) Medicinal preparations manufactured in accordance with formulas prescribed by the United States Pharmacopoeia, National Formulary or the American Institute of Homeopathy that are unfit for use for beverage purposes.

(c) Patented, patent, and proprietary medicines that are unfit for use for beverage purposes.

(d) Toilet, medicinal, and antiseptic preparations and solutions that are unfit for use for beverage purposes.

(e) Flavoring extracts and sirups that are unfit for use as a beverage, or for intoxicating beverage purposes.

(f) Vinegar and preserved sweet cider.

A person who manufactures any of the articles mentioned in this section may purchase and possess liquor for that purpose, but he shall secure permits to manufacture such articles and to purchase such liquor, give the bonds, keep the records, and make the reports specified in this Act and as directed by the commissioner. No such manufacturer shall sell, use, or dispose of any liquor otherwise than as an ingredient of the articles authorized to be manufactured therefrom. No more alcohol shall be used in the man-

ufacture of any extract, sirup, or the articles named in paragraphs b, c, and d of this section which may be used for beverage purposes than the quantity necessary for extraction or solution of the elements contained therein and for the preservation of the article.

Any person who shall knowingly sell any of the articles mentioned in paragraphs a, b, c, and d of this section for beverage purposes, or any extract, or sirup for intoxicating beverage purposes, or who shall sell any of the same under circumstances from which the seller might reasonably deduce the intention of the purchaser to use them for such purposes, or shall sell any beverage containing one-half of 1 per centum or more of alcohol by volume in which any extract, sirup, or other article is used as an ingredient, shall be subject to the penalties provided in section 29 of this Title. If the commissioner shall find, after notice and hearing as provided for in this section 5 of this Title, that any person has sold any flavoring, sirup, extract, or beverage in violation of this paragraph, he shall notify such person, and any known principal for whom the sale was made, to desist from selling such article; and it shall thereupon be unlawful for a period of one year thereafter for any person so notified to sell any such extract, sirup, or beverage without making an application for, giving a bond, and obtaining a permit so to do, which permit may be issued upon such conditions as the commissioner may deem necessary to prevent such illegal sales, and in addition the commissioner shall require a record and report of sales (41 Stat. 309)."

Admitted the principal Stein was authorized to manufacture toilet and antiseptic preparations, a solution unfit for beverage purposes, *and it cannot be controverted*, that the specially denatured alcohol withdrawn tax free by Stein was at the time of such withdrawal *unfit for beverage pur-*

poses. Subsequent to such withdrawal, it was required under the terms of the permit that the principal Stein add thereto certain essential oils and other ingredients for the purpose of completing the product, samples of which product had been submitted to the Treasury Department prior to the approval of the permit, and the purpose of which was to determine the potability of the finished product.

Pursuant to receipt of the basic ingredient specially denatured alcohol, the principal Stein proceeded to manufacture the products described by trade names in his application and approved by issuance of the permit.

Under the supervision of agents of the Bureau of Internal Revenue and upon completion of such manufacture, samples thereof were obtained and forwarded to the Division of Technology, Bureau of Internal Revenue, for analysis. It developed, at least allegedly, that while the formulae followed by the manufacturer Stein was quantitatively correct, there arose some question as to the quality of the essential oils used in the manufacture of the product, which according to the contentions of the Revenue Department were not of such quality as to render the finished product incapable of redistillation and manipulation for the purpose of securing a potable beverage alcohol.

The Record, Page 36 clearly indicates that the original sample of essential oil submitted to the Treasury Department was not available for the purpose of comparison with the essential oils used in the manufacture by the principal Stein and supervised by Revenue agents at the time of manufacture.

It is readily apparent that in the absence of the original approved essential oil that comparison of the oil used in the manufactured product with the approved ingredient is utterly impossible, but, going beyond that, the contention of the petitioner is this, that in the event the essential oil

was compared with the original approved essential oil ingredient, and even if such comparison proved that the manufactured oil was inferior, that such fact does not give rise to tax liability under the terms of the bond, unless and until it has been established that not only did such introduction of an inferior ingredient render the manufactured product potable or possibly potable, but that it must be established that diversion was actually established.

Under the facts of record in this case, it is submitted that not only did the evidence fail to establish diversion, but it definitely failed to establish either intent on the part of Stein, the principal, to so divert or knowledge of diversion on the part of others to whom he sold his finished product.

The provisions of Section 4 of Title 2, exempting certain articles from the provisions of the Prohibition Act, which in Paragraph D specifically exempts toilet products, provided that a person manufacturing such products may secure alcohol for such purpose, and shall not dispose of the same otherwise than as an ingredient of the articles authorized to be manufactured therefrom.

The most important part of the present petition with respect to tax liability is based on this Section, because of the fact that it provides that any person who sells any of the articles referred to in such Section, for intoxicating beverage purposes or under such circumstances from which the intention of the purchaser be reasonably deduced, shall be subject to the penalties of Section 29 of said Title, Section 29 being as follows:

> "Sec. 29. Any person who manufactures or sells liquor in violation of this title shall for a first offense be fined not more than $1,000, or imprisoned not exceeding six months, and for a second or subsequent offense shall be fined not less than $200 nor more than $2,000 and be imprisoned not less than one month nor more than five years.

> Any person violating the provisions of any permit or who makes any false record, report, or affidavit required by this title, or violates any of the provisions of this title for which a special penalty is not prescribed, shall be fined for a first offense not more than $500; for a second offense not less than $100 nor more than $1,000, or be imprisoned not more than ninety days; for any subsequent offense he shall be fined not less than $500 and be imprisoned not less than three months nor more than two years. It shall be the duty of the prosecuting officer to ascertain whether the defendant has been previously convicted and to plead the prior conviction in the affidavit, information or indictment. The penalties provided in this Act against the manufacture of liquor without a permit shall not apply to a person for manufacturing non-intoxicating cider and fruit juices exclusively for use in his home, but such cider and fruit juices shall not be sold or delivered except to persons having permits to manufacture vinegar (41 Stat. 316)."

It is readily apparent therefore that Section 29 is a penal provision and is therefore not involved in a proceedings on a bond having for its obligation the payment of taxes on alcohol withdrawn tax free and later diverted to beverage channels.

We rely upon this assertion to fortify our contention that error was committed by the Court below in failing to treat the proceedings below as a tax suit rather than a suit either to enforce a penalty or to enforce the obligation of a bond, the damage suffered under which has not been established.

It has been ruled by this Court in the *Zerbey vs. United States*, 282 Fed. 332 case that these bonds are measurable damage bonds as distinguished from forfeiture bonds. Accordingly, since the measure of damages in the instant case has never been established, it must be con-

ceded that the government considers the present bond to be a forfeiture bond and under their contention any failure whatsoever to comply with the rules and regulations, even to filing timely and monthly reports required by the terms of the permit, would justify invoking the penal provisions of the bond.

Such is not the case, for the reason that the laws and regulations pursuant to which a permit was issued, provide different proceedings for failing to comply with the terms of the permit, in that in one instance it provides that should the Commissioner find that the sale of any particular non-beverage product has been increased by reason of its susceptibility to manipulation for the purpose of securing a beverage alcohol, the Commissioner might cite the manufacturer to show cause why the manufacturing of such particular article or approved formula should not be revoked, and if upon hearing it should appear that manipulation was the real reason for the increased sale of such product, he might revoke the manufacturer's authority to continue such manufacture, and if upon failure of the manufacturer to comply with the order or direction of the Commissioner, he might revoke the permit in its entirety.

Again we point to the fact that in the revocation proceedings it is apparent from the original record that the Commissioner failed either to cite the manufacturer for revocation of the particular formula, but he also failed to give notice of desist from such manufacture.

Therefore, the Stipulation entered into with the plaintiff in the District Court in this present proceedings is very important in that the objections originally interposed to the introduction of certain testimony are doubly potent in this case, because of the difference in the proceedings and the different objectives in view, one having in mind the revocation of the permit and the present one having in mind the collection of taxes on alcohol withdrawn tax free, but later diverted to a taxable purpose and evidence of which is entirely lacking.

The Statute of Limitations applicable to tax matters limits the prosecution to a period of six years and definitely applies to the instant case inasmuch as tax liability must either be established by hearing or admitted by the principal within such period before a surety guaranteeing such taxes may be called upon to answer, as otherwise the mere giving of a bond might indefinitely toll the Statute and cause the surety to carry a potential liability forever.

It cannot be contradicted that with reference to the facts in the instant case the evidence does not sustain any tax liability based on diversion to beverage purposes, since it fails to establish that the alcohol withdrawn tax free by the principal, at any time found its way to a taxable beverage purpose. Therefore, the reference both by the District Court and Appellate Court to the opinion filed in the case of *United States vs. Bornn*, 104 Fed. 2nd, 641 does not apply because in the Bornn case it was definitely established that the permittee principal on the bond, Bornn, was fully cognizant of the purposes to which his product was being applied, and cooperated in such purposes by helping to promote increased sale and disposition of his product, suggesting to his salesmen that they inform prospective purchasers as to the methods to be followed in converting his articles to a potable beverage use, thereupon becoming a principal and a co-conspirator and accordingly, liable under his bond.

The Appellate Court in determining that the matter before it was not a tax suit but a suit upon a bond, apparently lost sight of the fact that such bond was given for the purpose of guaranteeing taxes, applicable to alcohol withdrawn tax free in the event and under the terms of the bond that such alcohol might be unlawfully diverted, and since there is no proof of diversion under the evidence, it must readily appear that tax liability cannot arise, and that thereafter the proceeding was a tax suit, based upon bond obligation arising out of tax liability established as

a result of evidence definitely proving the application of such taxes to the alcohol withdrawn under the terms of the permit and the supporting bond.

Respectfully submitted,
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Attorney for Petitioner.

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In the Supreme Court of the United States

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No. 524

HARRY STEIN, TRADING AS JEAN CHEMICAL COMPANY, AND NATIONAL UNION INDEMNITY COMPANY, PETITIONER[1]

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 40–42) and its opinion on motion for amended findings of fact and for a new trial (R. 43–45) are unreported. The opinion of the Circuit Court of Appeals (R. 49–51) is reported in 119 F. (2d) 677.

[1] The petition for a writ of certiorari purports (p. 1) to be that of "Harry Stein, trading as Jean Chemical Company, and National Union Indemnity Company, a corporation." However, the record indicates that an interlocutory judgment by default was taken against Stein (R. 15, 40) and that only the National Union Indemnity Company appealed from the final judgment (R. 15–16). By "petitioner" as used hereinafter, we refer to the National Union Indemnity Company alone.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 2, 1941 (R. 52). A motion for rehearing was denied May 19, 1941 (R. 54). The petition for a writ of certiorari was filed August 19, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1935.

QUESTIONS PRESENTED

1. Whether the evidence supports the findings that petitioner's principal, who had obtained specially denatured alcohol tax-free, unlawfully diverted it.

2. Whether the suit is one to recover for breach of the condition of the bond given by petitioner as surety, or is a suit to recover taxes guaranteed by the bond.

STATUTES AND REGULATIONS INVOLVED

The pertinent portions of the applicable statutes and regulations are set out in the Appendix, *infra,* pp. 10–18.

STATEMENT

On or about June 12, 1928, Harry Stein, doing business as Jean Chemical Company, pursuant to the National Prohibition Act (Tit. II, Secs. 4, 6, Tit. III, Sec. 13, Appendix, *infra,* pp. 10–15), secured a permit to withdraw and use specially denatured alcohol in the manufacture of certain toilet preparations (R. 23–24, 40). In order to

obtain the permit, Stein and the petitioner herein, National Union Indemnity Company, as surety, had theretofore executed a bond in the sum of $6,000 and in the form (Form 1480) specified by Treasury Regulations 3 (Revised August, 1927, Art. 112, Appendix, *infra,* pp. 17–18) issued pursuant to the Act. The condition of the bond was as follows (R. 40–41):

> Now, Therefore, the condition of this obligation is such that if there be no material false statement in the application for such permit, and the said principal shall not violate the terms of such permit, and shall transport, store, and use such denatured alcohol in accordance with the law and regulations made pursuant thereto, and shall in all respects fully and faithfully comply with all provisions of law now or hereafter enacted and all regulations promulgated thereunder respecting such transportation, storage, and use, and shall pay for all such denatured alcohol illegally or unlawfully diverted, lost, or unaccounted for in violation of such permit and law and regulations at the rate of $2 per wine gallon, and in addition thereto shall pay all penalties and fines imposed, then this obligation to be void; otherwise to remain in full force and virtue.

On or about November 8, 1928, Stein's permit was revoked by the Federal Prohibition Administrator (R. 17, 24). This action was sustained on review. *Stein* v. *Doran,* 46 F. (2d) 738 (C. C. A. 3d).

Thereafter, on September 25, 1935, the United States instituted the present suit by filing a statement of claim against Stein and the petitioner (R. 16–21). The statement alleged that between June 4, 1928, and August 4, 1928, Stein had illegally diverted and failed to account for 4,472 wine gallons of alcohol withdrawn tax-free under the permit. It set forth two causes of action, the first for damages at the rate of $2.00 per wine gallon for breach of the condition of the bond (R. 17–19), and the second for damages in the amount of the basic tax of $2.09 per wine gallon (R. 19–21). An interlocutory judgment by default was taken against Stein (R. 15, 40). The case against the petitioner surety was tried without a jury and, pursuant to stipulation, the transcript of testimony in the revocation proceeding was received in evidence (R. 29, 40).

The District Court found, in substance, as follows:

In June and July 1938 Stein manufactured and sold three batches of "Apple Blossom Toilet Water" and "Lilac Toilet Water," using in his manufacture 4,472 gallons of specially denatured alcohol withdrawn under his permit (R. 41). The toilet waters were not made in accordance with the prescribed Government formula and regulations in that they did not contain apple blossom oil or lilac oil, but were made, as intended by Stein, in such manner as to enable them to be turned into drinkable alcohol by a simple process (R. 41–42, 43–44). Each of the three batches was sold in bulk to a

single customer and the sales were not such as were ordinarily made in the course of business (R. 41). Two of the three customers had reputations of being "cover-up houses" (R. 41). Stein's purpose and intent in obtaining the denatured alcohol and in manufacturing and selling his product was to the contemplated end that after his product had passed into the hands of purchasers it would be "cleaned" of denaturants and other ingredients and ultimately be used for beverage purposes (R. 41–42). In such illegal use Stein knowingly cooperated by the conduct above recited (R. 42).

Upon the basis of these facts the District Court concluded that Stein's manufacture and sale of the toilet waters constituted an unlawful diversion of the alcohol and a breach of the condition of the bond (R. 42). It also concluded that recovery on the bond was not barred by the statute of limitations applicable to collections of penalties and forfeitures (R. 42). Judgment was rendered for the United States against Stein and the petitioner in the sum of $7,980, which was the amount of the bond plus interest (R. 47). Petitioner's motion for amended findings of fact and a new trial was denied (R. 43–45). On appeal by petitioner the court below affirmed the judgment (R. 52). A petition for rehearing was denied May 19, 1941 (R. 54).

ARGUMENT

The decision of the court below is not alleged to be in conflict with that of any other court and it

is in accord with that of the Circuit Court of Appeals for the Second Circuit upon analogous facts in *United States* v. *Bornn*, 104 F. (2d) 641, where this Court denied certiorari. *Bornn* v. *United States*, 308 U. S. 606; *Royal Indemnity Co.* v. *United States*, 308 U. S. 606. No question of general importance is presented. The case merely involves the liability of a surety upon a bond and the questions of law raised by petitioner do not call for further review.[2]

1. Petitioner contends (Pet. 4, Br. 10) that the evidence fails to show that Stein illegally diverted any of the denatured alcohol withdrawn under his permit. However, there was testimony directly supporting the findings of the District Court as to Stein's failure to use apple blossom or lilac oil (Tr. 45, 64, 81, 83–84, 86), as to the effect of such failure in rendering the toilet water capable of being made potable (Tr. 66–67, 84–85), as to the manner in which Stein sold his product (Tr. 97, 182–184), and as to the reputations which two of his purchasers had as "cover-up houses" (Tr. 99, 103–104, 108).[3] In addition, there was proof that Stein made no inquiries as to what his purchasers intended to do with his product, and that subse-

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[2] The petition contains no specification of the reasons relied on for allowance of the writ.

[3] The references "Tr." are to the typewritten transcript of the testimony in the revocation proceeding which was received in evidence in the instant case pursuant to stipulation (R. 29) and which is on file in the Court, although only in part included in the printed record, as stipulated (R. 55–56).

quently they refused to disclose to Government inspectors what they had done with it (Tr. 94, 98, 191). The reasonable inferences from all of this evidence warranted the District Court in its findings with respect to Stein's purpose and intent and the court below upheld the findings as being "amply supported by the record" (R. 51).

That Stein's activities, so found, constituted an unlawful diversion and hence a breach of the condition of the bond seems clear. *United States* v. *Bornn, supra; United States* v. *Van Schaak Bros. Chemical Works,* 33 F. Supp. 822 (D. C. N. D. Ill.). See *Various Items* v. *United States,* 282 U. S. 577, 580. Section 4 of Title II of the National Prohibition Act (Appendix, *infra,* pp. 10–12) made it illegal for any person knowingly to sell toilet preparations for beverage purposes or to sell them "under circumstances from which the seller might reasonably deduce the intention of the purchaser to use them for such purposes," and Section 3 specified that all the provisions of the Act should be construed liberally so as to prevent the use of intoxicating liquor as a beverage.

2. Petitioner also contends (Pet. 5, Br. 11, 13) that the suit is, in reality, one for the collection of taxes guaranteed by the bond, that the establishment of liability for taxes and of damages to the Government is a prerequisite of recovery, and that the suit is barred by the statute of limitations applicable to tax suits.

These contentions are without merit. Although the statement of claim alleged two causes of action, the second of which was for damages computed according to the basic tax rate, only the first cause of action, which was for recovery upon the bond, was sustained by the District Court and the court below. This is clear from their opinions, both of which followed the *Bornn* case where the Second Circuit granted recovery upon the bond (Form 1480), although holding that there was no liability for taxes. The condition of the bond required payment of the definite sum of $2 per wine gallon for each gallon illegally diverted irrespective of tax liability or of other damage to the Government, and, as said in the *Bornn* case, "there is no reason why the defendants should not be required to do what they agreed to do." 104 F. (2d) at 645. See also *United States* v. *Frost,* 80 F. (2d) 341, 343 (C. C. A. 5).[4]

Since the suit is one for recovery upon the bond, the statute of limitations governing the collection of taxes is inapplicable. *United States* v. *John*

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[4] In *United States* v. *Zerbey*, 271 U. S. 332, cited by petitioner for the proposition that proof of damages is necessary (Br. 11), the bond was a general compliance bond which did not require the payment of any definite amount such as the $2 per gallon specified in the bond herein. Cf. *Clark* v. *Barnard*, 108 U. S. 436; *United States* v. *Dieckerhoff*, 202 U. S. 302. Even assuming that proof of damages was necessary in the instant case, the decision below is correct, since 4,472 gallons at the rate of $2 per gallon exceeds the amount of the bond.

Barth Co., 279 U. S. 370, 375; *United States* v. *Frost, supra.* Nor is the suit barred by laches or by any other statute of limitations. *United States* v. *Mack*, 295 U. S. 480; *United States* v. *Borun, supra.*

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1941.

APPENDIX

NATIONAL PROHIBITION ACT, 41 STAT. 305:

TITLE II

SEC. 3. No person shall on or after the date when the eighteenth amendment to the Constitution of the United States goes into effect, manufacture, sell, barter, transport, import, export, deliver, furnish or possess any intoxicating liquor except as authorized in this Act, and all the provisions of this Act shall be liberally construed to the end that the use of intoxicating liquor as a beverage may be prevented.

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(U. S. C., Title 27, Sec. 12.)

SEC. 4. The articles enumerated in this section shall not, after having been manufactured and prepared for the market, be subject to the provisions of this Act if they correspond with the following descriptions and limitations, namely:

(a) Denatured alcohol or denatured rum produced and used as provided by laws and regulations now or hereafter in force.

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(d) Toilet, medicinal, and antiseptic preparations and solutions that are unfit for use for beverage purposes.

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A person who manufactures any of the articles mentioned in this section may purchase and possess

liquor for that purpose, but he shall secure permits to manufacture such articles and to purchase such liquor, give the bonds, keep the records, and make the reports specified in this Act and as directed by the commissioner. No such manufacturer shall sell, use, or dispose of any liquor otherwise than as an ingredient of the articles authorized to be manufactured therefrom. No more alcohol shall be used in the manufacture of any extract, sirup, or the articles named in paragraphs b, c, and d of this section which may be used for beverage purposes than the quantity necessary for extraction or solution of the elements contained therein and for the preservation of the article.

Any person who shall knowingly sell any of the articles mentioned in paragraphs a, b, c, and d of this section for beverage purposes, or any extract or sirup for intoxicating beverage purposes, or who shall sell any of the same under circumstances from which the seller might reasonably deduce the intention of the purchaser to use them for such purposes, or shall sell any beverage containing one-half of 1 per centum or more of alcohol by volume in which any extract, sirup, or other article is used as an ingredient, shall be subject to the penalties provided in section 29 of this Title. If the commissioner shall find, after notice and hearing as provided for in section 5 of this Title, that any person has sold any flavoring extract, sirup, or beverage in violation of this paragraph, he shall notify such person, and any known principal for whom the sale was made, to desist from selling such article; and it shall thereupon be unlawful for a period of one year thereafter for any person so notified to sell any

such extract, sirup, or beverage without making an application for, giving a bond, and obtaining a permit so to do, which permit may be issued upon such conditions as the commissioner may deem necessary to prevent such illegal sales, and in addition the commissioner shall require a record and report of sales (U. S. C., Title 27, Sec. 13).

SEC. 6. No one shall manufacture, sell, purchase, transport, or prescribe any liquor without first obtaining a permit from the commissioner so to do, except that a person may, without a permit, purchase and use liquor for medicinal purposes when prescribed by a physician as herein provided, and except that any person who in the opinion of the commissioner is conducting a bona fide hospital or sanatorium engaged in the treatment of persons suffering from alcoholism, may, under such rules, regulations, and conditions as the commissioner shall prescribe, purchase and use, in accordance with the methods in use in such institution, liquor, to be administered to the patients of such institution under the direction of a duly qualified physician employed by such institution.

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The commissioner may prescribe the form of all permits and applications and the facts to be set forth therein. Before any permit is granted the commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this title. In the event of the refusal by the commissioner of any application for a permit, the applicant may have a review of his decision before

a court of equity in the manner provided in section 5 hereof.

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(U. S. C., Title 27, Sec. 16.)

SEC. 29. Any person who manufactures or sells liquor in violation of this title shall for a first offense be fined not more than $1,000, or imprisoned not exceeding six months, and for a second or subsequent offense shall be fined not less than $200 nor more than $2,000 and be imprisoned not less than one month nor more than five years.

Any person violating the provisions of any permit, or who makes any false record, report, or affidavit required by this title, or violates any of the provisions of this title, for which offense a special penalty is not prescribed, shall be fined for a first offense not more than $500; for a second offense not less than $100 nor more than $1,000, or be imprisoned not more than ninety days; for any subsequent offense he shall be fined not less than $500 and be imprisoned not less than three months nor more than two years. * * * (U. S. C., Title 27, Sec. 46).

TITLE III

Industrial alcohol.

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Tax-free alcohol.

SEC. 10. Upon the filing of application and bond and issuance of permit denaturing plants may be established upon the premises of any industrial alcohol plant, or elsewhere, and shall be used exclusively for the denaturation of alcohol by the admixture of such denaturing materials as shall render the alcohol, or any compound in which it

is authorized to be used, unfit for use as an intoxicating beverage.

Alcohol lawfully denatured may, under regulations, be sold free of tax either for domestic use or for export.

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(U. S. C., Title 27, Sec. 80.)

SEC. 11. Alcohol produced at any industrial alcohol plant or stored in any bonded warehouse may, under regulations, be withdrawn tax free as provided by existing law from such plant or warehouse for transfer to any denaturing plant for denaturation, or may, under regulations, before or after denaturation, be removed from any such plant or warehouse for any lawful tax-free purpose.

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But any person permitted to obtain alcohol tax free, except the United States and the several States and Territories and subdivisions thereof, and the District of Columbia, shall first apply for and secure a permit to purchase the same and give the bonds prescribed under Title II of this Act, but alcohol withdrawn for nonbeverage purposes for use of the United States and the several States, Territories and subdivisions thereof, and the District of Columbia may be purchased and withdrawn subject only to such regulations as may be prescribed (U. S. C., Title 27, Sec. 81).

SEC. 13. The commissioner shall from time to time issue regulations respecting the establishment, bonding, and operation of industrial alcohol plants, denaturing plants, and bonded warehouses authorized herein, and the distribution, sale, export, and use of alcohol which may be necessary, advisable, or proper, to secure the revenue, to prevent diver-

sion of the alcohol to illegal uses, and to place the nonbeverage alcohol industry and other industries using such alcohol as a chemical raw material or for other lawful purposes upon the highest possible plane of scientific and commercial efficiency consistent with the interests of the Government, and which shall insure an ample supply of such alcohol and promote its use in scientific research and the development of fuels, dyes, and other lawful products (U. S. C., Title 27, Sec. 83).

SEC. 15. Whoever operates an industrial alcohol plant or a denaturing plant without complying with the provisions of this title and lawful regulations made thereunder, or whoever withdraws or attempts to withdraw or secure tax free any alcohol subject to tax, or whoever otherwise violates any of the provisions of this title or of regulations lawfully made thereunder shall be liable, for the first offense, to a penalty of not exceeding $1,000, or imprisonment not exceeding thirty days, or both, and for a second or cognate offense to a penalty of not less than $100 nor more than $10,000, and to imprisonment of not less than thirty days nor more than one year. It shall be lawful for the commissioner in all cases of second or cognate offense to refuse to issue for a period of one year a permit for the manufacture or use of alcohol upon the premises of any person responsible in any degree for the violation (U. S. C., Title 27, Sec. 85).

Revenue Act of 1926, 44 Stat. 9, 104–105:

> SEC. 900. Subdivision (a) of section 600 of the Revenue Act of 1918, as amended, is amended to read as follows:
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> "SEC. 600. (a) There shall be levied and collected on all distilled spirits now in bond

or that have been or that may be hereafter produced in or imported into the United States, in lieu of the internal-revenue taxes now imposed thereon by law, an internal-revenue tax at the following rates, to be paid by the distiller or importer when withdrawn, and collected under the provisions of existing law:

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"(3) On and after January 1, 1928, $1.10 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon.

"(4) On and after the enactment of the Revenue Act of 1926, on all distilled spirits which are diverted to beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage there shall be levied and collected a tax of $6.40 on each proof gallon or wine gallon when below proof, and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the person responsible for such diversion. If a tax at the rate of $2.20, $1.65, or $1.10 per proof or wine gallon has been paid upon such distilled spirits a credit of the tax so paid shall be allowed in computing the tax imposed by this paragraph.

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(U. S. C., Title 26, Secs. 1150, 1275.)

Revised Statutes:

SEC. 1047. No suit or prosecution for any penalty or forfeiture, pecuniary or otherwise, accruing under the laws of the United States, shall be maintained, except in cases where it is otherwise specially provided, unless the same is commenced within five years from the time when the penalty or forfeiture accrued: *Provided,* That the person of the

offender, or the property liable for such penalty or forfeiture, shall, within the same period, be found within the United States; so that the proper process therefor may be instituted and served against such person or property. (U. S. C., Title 28, Sec. 791.)

Treasury Regulations 3 (Revised August, 1927):

ART. 112. A manufacturer desiring to use specially denatured alcohol for manufacturing purposes must file application for permit on Form 1479, in duplicate, with the administrator of the district in which the applicant proposes to conduct his business. * * *

The application must recite the stipulations and conditions set forth in article 108 of these regulations numbered from 1 to 6, all of which must be faithfully observed and performed, and any act done or omitted to be done contrary to the terms and intent of such stipulations and conditions, or any misrepresentation of any fact found to have been made in securing the permit, shall be deemed a lack of good faith in conforming to the provisions of the national prohibition act, as amended and supplemented, and shall constitute good cause for issuance of a citation and the revocation of said permit.

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When deemed necesary the formula of the finished product, blue print, or diagram of apparatus, method of manufacture, samples, and advertising matter, or other data, must be furnished before approval will be given for the use of specially denatured alcohol.

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Formulas and samples of all preparations in which specially denatured alcohol is proposed to be used, other than those mentioned in the preceding paragraph, will be referred

to the commissioner for decision. The formulas and samples should be submitted in duplicate, one set of samples being sent by the applicant direct to the commissioner for analysis and the remaining set to the administrator to be retained by him. The duplicate formulas should be transmitted by the applicant to the commissioner. Where the applicant proposes to use mixtures of oils and ingredients which he procures from some other person, the composition of which is unknown to him, a 1-ounce sample of the ingredient or compound must be submitted with the finished sample when required.

Bond, Form 1480, must be filed by the applicant in duplicate. In case of the approval of the application the original bond will be retained by the administrator and the duplicate forwarded to the commissioner.

The penal sum of the bond shall in no case be less than $500, or more than $50,000, and shall be graduated in accordance with the quantity of alcohol on hand, in transit, or unaccounted for in each 30-day period.

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Where the quantity of alcohol involved is more than 5 wine gallons, but not more than 250 wine gallons, the penal sum of the bond shall be not less than $500. Where the quantity approved exceeds 250 wine gallons but does not exceed 500 wine gallons the penal sum shall be not less than $1,000. In the event of approval of larger quantities than 500 wine gallons, the penal sum will be computed at the rate of $2 for each wine gallon authorized to be withdrawn. Provided, that bonds given for larger quantities than 500 wine gallons must be in multiples of $1,000.

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